November 14, 2002

VIA ELECTRONIC FILING

The Honorable Magalie R. Salas
Federal Energy Regulatory Commission
888 First Street, NE
Washington, DC 20426

RE: Docket No. RM01-12-000, Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design

Dear Ms. Salas:

Forwarded herewith are comments of the Tennessee Regulatory Authority in the above-mentioned docket regarding standard market design.

Should you have questions, please contact Aster Rutibabalira, our primary staff person in the matter, at (615) 741-2904 ext. 150.

Sincerely,

/ s /

Sara Kyle, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Remedying Undue Discrimination Through Open Access Transmission Service and Standard Electricity Market Design	)))))	Docket No. RM01-12-000

COMMENTS OF THE TENNESSEE REGULATORY AUTHORITY

Executive Summary

The Tennessee Regulatory Authority (TRA) offers the following comments in response to the Commission's Standard Market Design (SMD) NOPR issued July 31, 2002.[1] The TRA commends the Commission for its efforts to address undue discrimination and other issues facing the electricity industry today. The TRA has many concerns, however, about the process that the Commission intends to use to solve those problems.

The TRA expresses the following concerns:

- The SMD NOPR does not present any evidence to back its claims. Considering the magnitude of the proposed SMD reforms, the TRA would prefer to see concrete evidence of continued instances of *"undue discrimination"* before these reforms are implemented.

1 Director Ron Jones concurs with these comments to the extent that the comments urge the preservation of Tennessee's jurisdiction. Director Jones neither supports nor opposes the assertion or submission of the remaining comments

- Without a detailed study, the implementation of the SMD may lead to problems between neighboring RTOs similar to those experienced between neighboring ISOs in the past. The TRA sees no guarantee of improved outcomes as a result of the proposed SMD. A cost-benefit analysis of the proposed SMD rule could provide assurances that it would produce a better result than the current structure.
- The Commission has not considered alternative regulatory approaches to the SMD that could solve most of the problems presented, as well as enhance economic efficiency.
- The Commission's remedy for asserted *undue discrimination* eliminates the ability of utilities to use their own facilities to serve their own customers and fulfill their own service obligations on a cost-of-service basis under state and local laws and regulation. It seems as though the Commission is attempting to assert jurisdiction over transmission used to fulfill state statutory service obligations requiring utilities to provide retail customers with bundled retail service. The proposed rule represents a sweeping and unprecedented assertion of federal jurisdiction over matters currently subject to state authority. The TRA supports continued state jurisdiction over such transmission.
- The Commission may not have considered all reform options and believes that state input on the nature of the reforms could produce alternative, creative solutions that better address states' needs.
- The TRA believes that different regions of the country have different needs and circumstances and that different regional market designs may be more appropriate than the one-size-fits-all approach proposed by the Commission.

- The proposed SMD is a fundamental change in the nature of regulation of the U.S. electric industry. The Commission should not proceed without supportive legislation enacted by Congress.
- Using CRRs to allocate transmission costs would be inconsistent with the principles of cost causation and should be abandoned. Even though the TRA supports participant funding, a great deal of detail on its implementation is needed before stakeholders can make informed comments and the restriction imposed by the SMD NOPR in order to qualify for participant funding should be lifted. Regarding LMP, the Commission did not prove that once SMD is implemented the resulting rates will likely be just and reasonable, that economic efficiency will most likely be enhanced relative to the risks created or relative to other alternative regulatory approaches that could be taken. Alternative pricing methodologies should have been given consideration. The TRA will address this issue in January 10, 2003 comments.
- The NOPR lacks directives on how market power is to be measured and identified. The TRA strongly prefers a clear definition of market power that can be applied on a going forward basis.
- While the idea of creating RSACs may address many of the states' concerns, there are a number of issues that have not been addressed by the NOPR, including which state entities are included in the RSAC and what should be the geographic scope of the RSAC. The TRA believes that a Joint Board, with adequate state representation, is the best approach to ensure that regional differences are incorporated in the SMD.

COMMENTS OF THE TENNESSEE REGULATORY AUTHORITY

The Tennessee Regulatory Authority (TRA) offers the following comments in response to the Commission's Standard Market Design (SMD) NOPR issued July 31, 2002. The Commission initially established a deadline of October 15, 2002, for public comments on the NOPR. This deadline was subsequently extended to November 15, 2002. *Notice of Conferences And Revisions To Public Comment Schedule (October 2, 2002).*[2] Although the TRA provides comments on some issues for which the deadline was extended to January 10, 2003, these comments will be complemented in future filings.

A. INTRODUCTION

The Commission believes that a single tariff for all transmission service, a single set of standard rules to be applied to transmission operations and wholesale electricity markets by Independent Transmission Providers (ITPs) throughout the United States, and spot markets for energy and ancillary services will enable reliable and economically efficient operation of the transmission system.

The Commission expects that most utilities will become part of a Regional Transmission Organization (RTO) and the RTO will serve as each utility's ITP. If a utility is not part of an RTO, it must contract with an independent entity to serve as an ITP for its transmission assets.

2 The Commission extended the deadline to January 10, 2003, for comments that address the following issues: (1) market design for the Western Interconnection; (2) transmission planning and pricing, including

The Commission's stated objectives are to remedy remaining undue discrimination and establish a standardized transmission service and wholesale electric market design that will provide a level playing field for all entities that seek to participate in wholesale electric markets. *Notice of Proposed Rulemaking. Remedying Undue Discrimination Through Open Access Transmission Service and Standard Market Design ("NOPR"), 67 Fed. Reg. 55452 (2002)* at ¶ 3.

The Commission states that its intention is to "provide new choices through a flexible transmission service, and an open and transparent spot market design that provides the right pricing signals for investment in transmission and generation facilities, as well as investment in demand reduction. *Footnote omitted. Id. at* ¶ 3.

The Commission plans to place sufficient regulatory backstops to protect customers against the exercise of market power when structures do not support a competitive market. *Id*. at ¶ 4.

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participant funding; (3) Regional State Advisory Committees and state participation; (4) resource adequacy; and (5) Congestion Revenue Rights and transition issues.

B. Problems Identified by the SMD

According to the *NOPR*, vertically integrated transmission owners and operators continue to use their interstate transmission facilities in ways that inhibit competition in wholesale power markets as well as competition in those retail power markets where states have adopted retail choice. Based on our analysis, the problems identified by the Commission either do not exist in the Southeast or, to the extent they do exist, can be resolved using existing institutions. In addition, we find that the problems identified by the Commission are either undocumented or unrelated to "undue discrimination."

The Commission claims that "the discriminatory preferences that these transmission owners and operators give to their own uses of the interstate transmission grid to serve their retail customers (whether or not they are in retail choice states) results in discrimination against, and in costs being borne by, other wholesale and retail customers who also rely on the interstate transmission facilities to buy power. The discriminatory preferences also create barriers to new sellers that could provide lower-cost power. This could result in higher prices to the native load served by the transmission owner." *Id.* at ¶ 31. However, the Commission presents no evidence to document this claim.

The Commission further suggests that much of this problem is directly attributable to the remaining ability of such vertically integrated utilities (and the existence of sufficient incentives) to exercise some degree of transmission market power in order to protect their

own generation market share. Id., at ¶ 36. The Commission did not present evidence to document this claim.

The Commission claims also that "[t]ransmission providers have failed to identify any native load growth at the time of the initial agreement, and disputes have arisen with customers claiming they were denied the ability to roll over their contracts because the transmission provider claimed, well after the contract was executed, that the transmission capacity at issue was required to serve native load growth." Id., at ¶ 41. The Commission provides no evidence that any contract renewal difficulties are the result of undue discrimination rather than simple problems of capacity.

The Commission's claim that "another type of anticompetitive behavior centers on a vertically integrated transmission provider delaying the processing of a competitor's request for new transmission service or interconnection (including the related system impact or facilities studies)" is also undocumented. Id., at ¶ 43. Delays by vertically integrated transmission providers in responding to requests for service can be easily resolved by the enforcement of existing rules. The Commission does not show that extraordinary measures such as the SMD are necessary.

The Commission points to several problems it perceives in the current system, which it proposes to fix with the SMD. For instance, the Commission identifies problems related to scheduling advantages for vertically integrated utilities which derive, in part, from the

Commission's own rules for Network Integration Service and firm Point-to-Point Transmission Service under the existing pro forma tariff. Id., at ¶ 45.

The Commission claims that "transmission providers with generation and load of their own can resolve their own energy imbalances through in-kind energy exchanges with neighboring systems. In contrast, other customers of the transmission provider face higher costs if they take service from other suppliers that could balance against each other. This difference gives the transmission provider a competitive advantage over other sellers of power." Id., at ¶ 48. The Commission also asserts that "manipulation or violation of OASIS posting requirements and the Commission's standards of conduct is another way vertically integrated transmission providers that control their own OASIS sites are able to engage in undue discrimination." Id., at ¶ 52. Finally, the Commission alleges that "when a vertically integrated transmission provider injects power from its own generation onto its own power lines to meet the constantly shifting demands of the load on its system, it has both the opportunity and the incentive to manipulate the transmission system for its own benefit." Id., at ¶ 59.

The *NOPR* provides no specific evidence that preferential use of transmission to serve native retail customers has been abused by utilities anywhere in Tennessee or in the Southeast. The proposed rule offers only theoretical examples of how vertically integrated service to native load *could* disadvantage other utilities. Further, the *NOPR* provides no specific evidence that ultimate consumers have been, or would be, harmed if

utilities continue integrated operation of transmission and generation primarily to serve their customers.

The TRA is concerned that the Commission has not presented clear and abundant real-world evidence for at least one region of the country in support of the existence of "undue discrimination." The TRA would prefer the Commission to make such a finding for at least one region, and to show that, in that specific region, undue discrimination in the pricing and/or access to transmission services has a significant effect on the average price and competitiveness of power in the wholesale generation market. Further, the Commission should show that the economic efficiency of the entire transmission and generation system will be significantly enhanced by the proposed SMD.

Clearly, this *NOPR* describes several examples of potential discrimination by vertically integrated utilities, all of which, if they occur, could impede the development of competitive electricity markets. The TRA, however, maintains that these problems exist only in theory or are only perceived problems. The TRA is not comfortable with the implementation of reforms of the magnitude of those in the proposed SMD without documented evidence in support of the Commission's claims of "undue discrimination."

C. Many of the Problems Identified are Unrelated to Discrimination by Vertically Integrated Utilities and to SMD.

The Commission does admit that new problems have been created by some market design experiments. In regions of the country where the separation of transmission from generation has been addressed through the creation of ISOs (which, in some instances, have placed nearly all load under a single tariff), market design flaws create inefficiencies in the marketplace and opportunities for the exercise of market power. Conflicting market rules and procedures in neighboring ISOs have created or perpetuated seams problems that impede the economic flow of power from one region to another. All of these problems have hindered the progress towards competitive regional electricity markets. Id., at ¶ 37. Clearly, the Commission-approved market design experiments have led to problems in some cases. Before a new nationwide SMD experiment is implemented, the Commission should provide a detailed analysis of what went wrong with SMD experiments already in place, as well as a study of potential solutions to those problems. The consequences of a nationwide market design experiment, should it fail to address previous problems or in some other way go awry, could be disastrous.

In addition, the problems with the market design experiments, as they have been analyzed thus far and as they are presented in the *NOPR*, are not due to vertically integrated utilities or to discrimination on their part.

Without a detailed study, the implementation of the SMD may lead to problems between neighboring RTOs similar to those experienced between neighboring ISOs in the past. Without a cost-benefit analysis of the proposed SMD, the Commission has no evidence that better outcomes will result from this SMD. The TRA is concerned that the problems the Commission highlights may not be addressed by the SMD, while this vital industry will be subjected to potential inefficiencies in the marketplace, opportunities for the exercise of market power, and risk of market gaming like that experienced in California.

D. There Are Alternative Solutions to the Problems

The Commission does not appear to have considered alternative regulatory approaches to the SMD that would both address the stated problems and enhance economic efficiency. In addition, the Commission has not quantified the net benefit of the SMD on each region or the nation before claiming that the SMD will benefit the nation's consumers.

Without studies comparing the costs and benefits of solving identified problems with the proposed SMD to the costs and benefits of solving the same problems through alternative solutions, the TRA is not convinced that a revolutionary process like the SMD is the best course of action. Alternative solutions could include enforcement of existing rules by the Commission, state commissions, RTOs and ITPs or allowing independent entities such as RTOs or ITPs to solve the problems within their respective footprints without resorting to a one-size-fits-all SMD. An RTO, ITP or similar organization could, for example, operate all transmission facilities independently, solve all problems related to perceived

discrimination, seams issues, load growth and capacity planning issues, and eliminate the preference for future native load growth without necessarily using Congestion Revenue Rights (CRRs). These organizations could perform studies and calculate Available Transfer Capacity (ATC), eliminate scheduling advantages and other preferential treatment, create a resolution procedure for energy imbalances, and create a mechanism to manage congestion.

Alternatively, the Commission could fix loopholes identified in FERC's own rules in Order 888 instead of resorting to a national reform of the SMD's scope. The Commission could also create a mechanism to detect and deter the exercise of market power.

The TRA believes that without a cost-benefit study, it is difficult to know the costs and benefits of the proposed SMD relative to the costs and benefits of alternative solutions. It is possible that the SMD will lead to greater inefficiencies, higher retail rates, or more energy imbalances between regions.

Indeed, a study of the short-run benefits of TRO formation, SMD implementation and participant funding implementation in the Southeast[3] shows that (1) there is a considerable uncertainty as to whether RTOs and SMD would provide greater benefits to the Southeast than the implementation costs; (2) there are "negative" benefits for the GridSouth and GridFlorida areas; and (3) there are some positive net benefits in at least

some scenarios for SeTrans area even though there is some uncertainty about the magnitude of those net benefits.

The study concludes that for the study period 2004-2013, the net benefits of forming three (3) RTOs and implementing SMD are negative for all three RTOs. The adoption of participant funding would result in additional net benefits in the SeTrans area, while net benefits for GridSouth and GridFlorida remain negative.

These results show that the net benefits of SMD implementation are at best ambiguous. It is our opinion that participant funding can be implemented outside the SMD framework, thus producing net benefits to most regions without the Commission's assertion of federal jurisdiction over matters currently subject to state authority.

Based on these findings, the TRA recommends that the Commission sponsor a national study of the net benefits of SMD implementation before implementing any market designs.

3 The Benefits and Costs of Regional Transmission Organizations and Standard Market Design in the Southeast, Prepared for the Southeastern Association of Regulatory Utility Commissions, Charles River Associates, Washington, DC (November 6, 2002).

E. Common Governing Rules

The TRA agrees with the Commission that the lack of common rules governing the operation of a transmission system makes it difficult for that system to support an efficient regional electric power market. Id., at ¶ 62. The TRA disagrees, however, that a single common set of rules must govern the operation all transmission systems in the United States. With a single, national SMD, there are many regional differences that will likely be given inadequate attention. Such differences should shape any SMD, so that each region is governed by its own SMD principles while all regions agree on rules to settle regional differences.

The TRA agrees that if the interstate transmission system is to provide fair and efficient movement of power on behalf of all users of the system, each region should have the same general rules governing such matters as who gets service, who has the right to transmission service when not all service requests can be accepted, how the transmission facility costs are allocated among transmission customers, whose transmission is curtailed and by how much when a transmission outage prevents all the planned services from being accommodated, who plans the additions to the grid, and who pays for these additions. The TRA has seen no evidence that these issues are best addressed at the national level rather than at the regional or at the utility level.

California's market design led to the gaming of its energy system by Enron and other energy companies. Such gaming does not exist in the Southeast. Rules intended to

address these problems are second-best solutions that need only be adopted where these problems exist. The TRA affirms that it is inappropriate to subject the Southeast region to rules, intended to correct problems in California, that may produce less efficient economic outcomes than those currently enjoyed in the region.

Aggressive control of market power and aggressive market-power monitoring are indispensable to the development of a competitive electricity market. These are desirable features to include in any SMD. The TRA is unconvinced, however, that the proposed SMD will prevent such abuses, especially since penalties are left to transmission organizations that have not yet been formed and which have an as yet undefined system of governance.

F. The *NOPR* Emphasizes a Market-Based System

Tennessee is among a number of states that have, after careful deliberation, chosen not to implement a policy of retail competition for electricity consumers. Most consumers in Tennessee receive electricity as a fully bundled service (generation, transmission, distribution, and metering) from the Tennessee Valley Authority (TVA), state or municipally regulated utilities, and investor-owned utilities. With the exception of TVA, utilities in Tennessee operate under state laws that impose on them an obligation to meet the service needs of their customers. Consumer retail rates are cost-based and set at a level sufficient to recover the investment and operating costs necessary for the utility to fulfill its service obligations. Tennessee's system has worked well for decades.

Consumers in Tennessee continue to enjoy reliable and low-cost electricity service. This system is in no way broken, and the TRA sees no reason to apply a FERC-imposed fix.

In states with bundled retail service, utilities build generation and transmission facilities or contract for power and transmission in order to fulfill their statutory service obligation. The investment and operating costs of these transmission and generation assets are recovered in customers' retail rates. Thus, retail customers have bought and are paying for the facilities that the Commission now finds cannot be used preferentially to serve them. The rulemaking correctly observes that the majority of capacity on transmission facilities is devoted to serving bundled retail load. This is not surprising; retail service was and is the primary purpose of these facilities. It is why the facilities were built in the first place.

The Commission's proposed rule will fundamentally disrupt the ability of states to maintain a cost-based, public service electricity system, because the rule prohibits a utility from coordinating the operation of its generating facilities with its transmission facilities for the purpose of providing service to its retail customers at least cost. Moreover, the new rule will make it extremely difficult, if not impossible, for the utility and its state regulator to plan for new generation and transmission facilities in an integrated manner for the purpose of meeting future customer loads at least cost.

In sum, the Commission's remedy for asserted undue discrimination eliminates the ability of utilities to use their own facilities to serve their own customers and to fulfill their own service obligations on a cost-of-service basis under state and local laws and regulations.

G. The *SMD NOPR* Does Not Include Input From All Stakeholders

The *NOPR* is a very large document of more than 600 pages in length. It advocates many theories that are difficult to digest in a short time period. While the Commission seeks comments on how its regulations should address several important issues, it proposes its own solutions as a basis for comment, leaving no room for states to present alternative, creative solutions that might better serve their energy customers.

The proposed SMD is too important and too radical for the Commission to proceed without a full opportunity for the public to understand, and comment on a fully developed and fully defined notice of proposed rulemaking that provides real evidence of the alleged problems and real evidence of the expected costs and benefits of a clearly defined proposal.

The timetable for getting to a final SMD is very aggressive and does not allow enough time for input from stakeholders. While the TRA appreciates the flexibility the Commission has shown in extending the deadline for SMD comments, the Authority would prefer that there be no date certain in the NOPR and that regions have the opportunity to comply with elements of the SMD in phases.

H. One-Size-Fits-All Is Not Appropriate

While this SMD is modeled after PJM Interconnection[4] and assumes that electricity markets will be competitive nationwide, many parts of the country have not deregulated their electricity markets and have no experience with a market design. The Commission must understand that different regions of the country have different needs and circumstances and that different regional market designs may be more appropriate than a one-size-fits-all approach. The TRA remains concerned that SMD will allow market participants to take advantage of differences among regions, raising energy prices for those in low-cost energy regions.

The impact of the proposed SMD on each region will depend primarily on the similarities or lack thereof of different regional electric systems. Regions with heavily hydro-based systems (like the Pacific Northwest), regions with thermal systems, regions with heavily coal-based or natural gas-fired systems, and regions with mixed systems have historically different costs. While the goal of allowing the most efficient systems to produce and disseminate the most energy is laudable, regions with relatively inexpensive energy should not suffer higher prices in order to lower the costs in those regions with comparatively higher costs.

4 The PJM ISO was formerly called the Pennsylvania, New Jersey, Maryland Power Pool and serves New Jersey, Maryland, Delaware, much of eastern Pennsylvania, the District of Columbia, and a small area of Virginia.

The SMD is likely to have a profoundly negative impact on low cost states' electric consumers by causing prices to rise significantly, while not exercising the tight control on market power necessary to prevent abuses. Low cost states' consumers enjoy electricity prices below the national average due to inexpensive generation, careful management of the grid, and appropriate public policies decided by state commissions. It is the TRA's opinion that these consumers should not be adversely affected by solutions to problems existing in high cost states.

The Commission should keep in mind that many of the problems we are seeing today with inadequate transmission infrastructure exist only because a system that was built to serve load under a cost-based design is now expected to support millions of additional wholesale transactions that occur solely because of the move to deregulated, profit-based systems. Congestion and inadequate infrastructure are the result of wholesale deregulation, and the TRA has not been convinced by the evidence thus far presented by the Commission that further deregulation holds the most promise for solving these problems.

If the Commission is intent upon proceeding with the untested market experiment described in the *NOPR*, the TRA believes that consumer-owned utilities, federal electric utilities and federal power marketers should remain exempt from the Commission's jurisdiction. This would safeguard states that do not currently suffer generation and transmission inefficiencies from the market disruptions that would result should the SMD fail to produce the efficient, competitive market envisioned by the Commission.

The TRA's preferred course of action would be that the Commission suspend or withdraw the *NOPR* and convene a contested case hearing on the matter. This would allow the Commission to present evidence of the claims of undue discrimination that underlie the reforms, as well as provide a forum for stakeholders to advance their points of view on the best way to construct a national competitive energy market. Regions and states should have the opportunity to assess their own market needs and to present recommendations to the Commission before the Commission imposes a "one-size-fits-all" market design on all regions and states.

In the Southeast, the public has been well served by giving a limited role to unregulated electricity markets, a structure through which Southeastern states have maintained prices well below the national average. The TRA strongly opines that the Commission needs to show how the SMD will prevent transmission owners and power generators from exploiting and manipulating the system as they did in California. Tennessee customers need assurances that the SMD has a trustworthy plan to prevent abuse. States and regions that have no current energy crisis and enjoy affordable, reliable electricity provision are understandably reticent to move to an untested competitive market system that is designed to prevent problems that we do not have. It is the opinion of the TRA that any potential benefits will accrue to some states or regions, while those that currently have no energy crisis remain at risk of suffering from increased costs.

I. The Conflict Between Federal and State Jurisdiction

The *NOPR* asserts the Commission jurisdiction over the transmission portion of bundled retail sales, and it assumes that electricity markets will be competitive nationwide. There is an underlying assumption in the Commission's *NOPR* that a competitive, market-based system is necessarily superior to a regulated cost-based system in every region and every state. The existing investment that retail customers have made in generation and transmission facilities, as well as the reliable, low-cost service that many enjoy, may raise questions about the validity of that assumption in some regions and states. SMD does not allow state commissions to choose the system that is best for their residents and will, therefore, have a serious impact on state commissions' ability to fulfill the responsibilities with which they have been charged under state laws.

The TRA opposes the expansion of the Commission jurisdiction to include bundled retail transmission service. States should retain authority to establish retail transmission rates unless such rates violate federally determined open-access, non-discriminatory, competitive transmission policies. The TRA supports the Commission's continued exercise of ratemaking authority for interstate wholesale transactions and jurisdiction over transactions between suppliers and retail customers located in different states, but the TRA contends that the Commission should defer to states' authority to establish retail bundled transmission rates. Given these positions, the TRA urges the Commission to omit the sections of the *NOPR* that give the Commission jurisdiction over bundled retail transmission.

The *NOPR* proposes to require ITPs under the Commission's sole jurisdiction to establish regional resource adequacy requirements. It also authorizes the ITPs to impose those requirements and penalties for non-compliance on retail load-serving utilities, regardless of whether those utilities are otherwise exempt from the Commission's jurisdiction (e.g., federal, municipal utilities and cooperatives). All of these areas—bundled retail service, retail demand response, and generation resource planning and adequacy—fall under state jurisdiction. They are matters of state policy determined by state legislatures and implemented through state regulation.

The Federal Power Act clearly reserves these matters to the states. The recent U.S. Supreme Court decision in *New York v. FERC* does not, contrary to the Commission's assertion in its *NOPR*, find that the Commission has jurisdiction over bundled retail sales. In its opinion, the Court makes clear that it is *not* deciding that jurisdictional question (as Enron was urging), because the Commission had not (yet) asserted jurisdiction. Indeed, the Commission argued to the Court, in opposition to Enron, that "The Commission's reasonable finding that it lacks jurisdiction over the transmission component of bundled retail sales under Section 201 therefore precludes the Commission from regulating that transmission component under Section 206."[5]

Furthermore, the U.S. Supreme Court observed that, were the Commission to assert such jurisdiction, this would pose complex jurisdictional issues:

5 "Brief for the Federal Energy Regulatory Commission" In the Supreme Court of the United States. State of New York, et al. v. Federal Energy Regulatory Commission, et al., Enron Power Marketing, Inc. v. Federal Energy Regulatory Commission, et al. Nos. 00-568 and 00-809. May, 2001. Page 49.

> It is obvious that a federal order claiming jurisdiction over *all* retail transmissions would have even greater implications for the State's regulation of retail sales—a state regulatory power recognized by the same statutory provision that authorizes FERC's transmission jurisdiction. But even if we assume, for present purposes, that ENRON is *correct* in its claim that the FPA gives FERC the authority to regulate the transmission component of a bundled retail sale, we nevertheless conclude that the agency had the discretion to decline to assert such jurisdiction in this proceeding in part because of the complicated nature of the jurisdictional issues. [Emphasis in original][6]

In any event, the case the Commission cites addressed only transmission jurisdiction, not jurisdiction over resource planning, adequacy standards, or retail demand management.

In our opinion, the Commission's role is one of policing the wholesale transmission and generation markets. Respecting current authorities, the Commission should work with the states and regions to identify real problems and customize solutions to fit those problems.

J. Transmission Pricing

The *NOPR* calls for bidding out transmission rights. This means that ratepayers who paid for a particular transmission system would not have guaranteed access to that system. The *NOPR* offers little protection for existing transmission rights, including rights to serve native load growth, change pre-schedules and points of delivery without penalty. After a four-year transition, the Commission calls for all transmission rights to be put up for auction. This would force small rural utilities to compete with deep-pocketed

6 *New York v. FERC*, 535 U.S. 1__(2002), page 26; 152 L.Ed.2d 47 () (2002).

marketers and financial institutions for the transmission capacity the utilities need to keep on their customers' lights. The Commission actually states that the goal is to ensure that "customers that value the transmission the most will get it." In other words, the goal is to ensure that those who can afford to drive up the price of transmission the highest will get to move power. The Commission does not even require those bidding to have any intention of delivering power. The *NOPR* states that "Once a customer has these point-specific Congestion Revenue Rights, the customer may sell them at any time to another entity, whether or not that entity intends to transmit power. The sale could be for all or a portion of the amount or duration of the Congestion Revenue Rights." Id., at ¶ 162

The Commission seeks comment on whether all customers should be charged the same transmission rate either upon implementation of SMD or after a reasonable transition period of four years. Id., at ¶ 178. The TRA believes that the *NOPR* should be withdrawn to allow the U.S. Congress to put in place SMD legislation that will guide the Commission in this effort, making the four-year transition issue moot.

Regarding the rates for bundled retail customers, the TRA urges the Commission to utilize a pricing policy that allows the demonstrated cost of investments, determined through an even-handed assessment of transmission, generation and efficiency alternatives as necessary to maintain the reliability of the existing transmission system, to be recovered through rates paid by all transmission customers. In addition, the TRA believes that the cost of upgrades and expansions that are necessary to support incremental new loads or demands on the transmission system must be borne by those

causing the upgrade or expansion to be undertaken, though the TRA does not believe that the Commission should preclude the assignment of interconnection costs to the general body of ratepayers within a state when that state's regulatory body determines that such allocation is in the public interest.

The *NOPR* requires ITPs to provide a nondiscriminatory, standard transmission service to all customers. The new service is called Network Access Service (NAS). Id., at ¶ 136. This implies that NAS would not be just a tariff for access to the transmission grid, but also a tariff for pricing all aspects of transmission service. Nevertheless, the Commission did not quantify the impact of NAS on transmission cost.

According to the *NOPR*, Network Access Service will give all customers the opportunity to have tradable CRRs that will expand their transmission options and enhance competition in wholesale electric markets. It also will result in all transmission services being performed under a single set of rules. Id., at ¶ 136. The TRA believes that using CRRs to allocate transmission costs would be inconsistent with the principles of cost causation and should be abandoned. The TRA will address this issue in the January 10, 2003 comments.

K. Participant Funding

Although the *NOPR* elaborates significantly on other transmission pricing methodologies, it remains almost silent on how participant funding will be implemented. Even though

the TRA supports participant funding, a great deal of detail on its implementation is needed for stakeholders to make informed comments.

The *NOPR* proposes recovery of the costs of expansion through participant funding, i.e., those who benefit from a particular project (such as a generator to export power or load building to reduce congestion) pay for it. *Id.* at ¶ 197. The TRA supports this cost causation approach and believes that participant funding is the appropriate pricing approach for new transmission and upgrades, regardless of which party planned the construction. The *NOPR* requires, however, that transmission planning be conducted by an ITP or similar organization, and that any upgrades requested be part of a regional plan. Therefore, the TRA believes that the restriction imposed by the *NOPR* should be lifted.

L. Locational Marginal Pricing (LMP) and Energy Markets

The *NOPR* states that marginal pricing is the idea that the market price should be the cost of bringing the last unit to market (the one that balances supply and demand). LMP in electricity recognizes that the marginal price may differ at different locations and times. Differences result from transmission congestion, which limits the transfer of electricity between the different locations. The marginal price of energy at a particular location and time – that is, the energy LMP – is the additional cost of procuring the last unit of energy supply that buyers and sellers at that location willingly agree on to meet the demand for energy. That is, it is the price that "clears the market" for energy. Id., at ¶ 204 *(footnotes omitted).*

The Commission states: "The real time price of energy is determined through a security-constrained, bid-based energy market run by the ITP. The ITP uses the bids to select the lowest-cost energy within the operational limitations of the transmission system." Id., at ¶ 222. The Commission did not prove that once the SMD is implemented the resulting rates will likely be just and reasonable or that economic efficiency will most likely be enhanced relative to the risks created and other alternative regulatory approaches that could be taken.

M. Real-Time Energy Markets: *Ex Post* versus *Ex Ante* Price

The *NOPR* states that "[i]mmediately in advance of each upcoming 5-minute period, the ITP would announce the real-time energy prices that it estimates will clear the market and match generation with load during that upcoming period (based on the real-time bids submitted by market participants). The ITP could settle all departures in real-time from the day-ahead schedule using these prices announced in advance. Id., at ¶ 313. Using ex-ante prices, "[s]ome bidders may not respond to the announced prices in the way suggested in their bids… [b]y settling at the ex ante price, [a] generator could be paid the higher price despite the fact that it did not increase its output as it had promised in its bid." Id., at ¶ 314.

Using *ex-post* prices, "the price used to settle real-time deviations from day-ahead schedules could be the price-bid associated with the energy observed ex post to be produced by the marginal supplier in the 5-minute period (but not higher than the

advisory price announced ex ante). Such an ex post price rule would encourage suppliers to supply the full amount of energy promised in their bids." Id., at ¶ 314.

The Commission proposes to adopt the *ex-post* rule because it creates incentives for bidders to act in a manner consistent with their bids and seeks comment on the choice between *ex-post* and *ex-ante* pricing. Id., at ¶ 315. The Commission believes that *ex-post* prices should be used to settle all departures in real time from the day-ahead schedule. While the TRA agrees that *ex-post* pricing of electricity imbalances is the appropriate methodology, the *ex-post* pricing mechanism provided in the *NOPR* should not be the only mechanism the Commission is willing to accept. Alternative *ex-post* pricing methodologies, such as the Wide Open Load Following (WOLF) methodology, should be given consideration.[7] In addition, the TRA is not convinced that there is a sound economic reason for settling electricity imbalances in the 5-minute period, or that such a system would produce the best outcome. Shorter intervals may be more appropriate.

N. Market Monitoring and Mitigation

The *NOPR* presents three mandatory mitigation measures and a fourth voluntary measure. These measures apply only to the day-ahead and real-time spot markets, but the *NOPR* asserts that they should be sufficient in controlling market power in bilateral long-term markets. *Id.* at ¶ 405.

7 *See* Initial Comments on Discussion Papers by Mark B. Lively, Electricity Market Design and Structure, Docket No. RM01-12-000.

The first is the use of unit-specific bid caps as established by the ITP to limit localized market power in transmission-constrained load pockets. *Id.* at ¶¶ 399, 406-412, 418-427. The Commission does not include the details of how these units would be specified. In theory, the bid caps should prevent generators from bidding at levels above their marginal cost of generation. Given that marginal cost of generation varies between generation plants largely depending on the spot market cost of fuel, emissions allowances, the physical condition of the plant, and the plant efficiency in generation, the determination of the bid caps will be very complex. The bid caps will likely be somewhat volatile, making it difficult for the ITP to ensure that they are properly computed and that no bids over marginal cost take place.

For the second mitigation measure, in order to address the current lack of sufficient demand-side response in bid-based energy markets, the *NOPR* proposes the use of a safety-net bid cap, similar to the $1,000 per MWH cap currently used in Northeast markets and Texas. *Id.* at ¶¶ 400, 413-414. The Commission seeks comments on whether uniform safety-net caps should be applied across an entire interconnection grid and on how to establish the value of such caps. *Id.* at ¶ 413. The TRA believes that while a uniform safety-net cap in each interconnection grid may be desirable, the marginal cost of power generation varies depending on the production inputs (hydro, gas, coal, wind, etc). Further, within a single interconnection grid, the marginal cost of power varies across regions and depends somewhat on the exposure to spot market prices. Thus, a uniform safety-net cap may not be appropriate for an entire interconnection grid.

The third measure is the resource adequacy requirement, established to diminish the incentives and ability of suppliers to practice and profit from either physical or economic withholding *Id.* at ¶ 401. The fourth measure, which is voluntary and applied as needed, is intended to address certain situations conducive to or indicative of generation withholding. It is similar to the Automatic Mitigation Procedure (AMP) used in the New York ISO *Id.* at ¶¶ 402, 415-417.

Although the *NOPR* invites each ITP's Market Monitoring Unit (MMU) to conduct a market assessment to determine the persistence of load pockets or other market power concerns, it lacks directives on how market power is to be measured and identified. The TRA believes that these measures are still too vague, making it impossible to know if they will be effective in mitigating market power. Because experience has shown that the Commission may fail to recognize and prevent the abuse of market power, the TRA strongly prefers a clear definition of market power that can be applied on a going forward basis.

O. State and Federal Cooperation (¶¶ 474, 491, 524, 552, 553)

The *NOPR* proposes a formal role for states, with each ITP having a relationship with a Regional State Advisory Committee (RSAC) that would share the oversight of the ITP with the Commission. The National Governors' Association, in a recent report entitled "Interstate Strategies for Transmission Planning," recommended establishing "multi-state entities" to facilitate state coordination of transmission planning, certification and siting at the regional level *Id.* at ¶ 552. RSACs will follow the proposed model, but will also

have responsibilities in market power monitoring and mitigation as well as in resource adequacy, setting a region's minimum level for reserves and its planning horizon *Id.* at ¶ 552.

To insure the efficiency and reliability of the electric industry as a whole, state and federal collaboration is vital. If state commissions aim only to satisfy narrow interests within state boundaries and if the Commission only pursues interests under its jurisdiction, contradictory policies may result and the interest of the consumers may be adversely affected.

An example is the apparent conflict between the protection of native load customers by each state's transmission owners and the non-preferential treatment of such customers advocated in SMD. Without regional coordination, a period of congestion could jeopardize the integrity and reliability of the entire system. States looking to protect their own customers could compound the problem. A regionally coordinated effort can protect customers and minimize congestion, provided that the Commission involves state commissions and takes into account their input.

Whether the subject of interest is the formation of RTOs, market design, options paper, mitigation of market power, demand response, new transmission siting and pricing, new power plant siting, or some other issue, the TRA maintains that state input should be considered. Many forms of state participation have been used in the past, including a collaborative process, working groups, technical conferences and workshops, mediation

processes, advisory panels, and joint boards. Of all these forms of state participation, the TRA believes that a joint board is the most appropriate for the current reform effort. Only the Joint Board was mandated by Congress in Section 209 of the Federal Power Act (FPA), which authorizes the Commission to convene joint boards with state PUCs. A joint board is likely to make recommendations acceptable to all stakeholders, including the authority making the final decision. A joint board, with adequate state representation, is the best approach to ensure that regional differences are incorporated in the *NOPR.*

The TRA is concerned that, while the idea of creating RSACs may address many of the states' concerns, there are a number of issues that have not been addressed by the *NOPR.* The TRA has many questions, including which state entities are included in the RSAC (i.e., governor's appointee, public utility commissioners, state department of energy or department of economic development, etc.), what should be the geographic scope of the RSAC, whether states neighboring an RTO or an ITP should have representatives on the RSAC. These are a few among many questions that the *NOPR* did not address and they are key to whether or not a stakeholder supports state and federal cooperation. The TRA recommends that the Commission analyze and contrast both the joint board and RSACs before making a final decision on what form of state participation to include.

P. Regional Planning Process

The *NOPR* proposes the implementation of regional planning processes across defined planning areas (i.e., PJM, MISO) and requires that a regional plan be completed for each planning area within twelve months of the effective date of the order *Id.* at ¶ 590. The TRA is concerned that the *NOPR*'s requirements for the required plan are not clear.

The *NOPR* requires that the regional planning process identify beneficial transmission levels needed to ensure reliability and meet economic needs, but leaves open the question of how and by whom those needs should be met *Id.* at ¶¶ 473, 503. Following the identification of needs, the ITP will conduct an RFP process to solicit solution alternatives and then evaluate submitted proposals. If the RFP is unsuccessful, the ITP may then order transmission solutions that would be the responsibility of the affected transmission owner.

The *NOPR* does not allow for the ITP to establish a method of identifying upgrades that may be needed to mitigate reliability, nor does it provide a method for distinguishing reliability from economic needs. The *NOPR* puts the responsibility for such determination on the ITPs. Should the RFP be unsuccessful, ITPs would have to solicit additional proposals. Such a process does not seem optimal and could significantly delay the overall regional transmission planning process.

The TRA commends the Commission for accepting that there are problems in the electricity industry today and recognizing that such problems need to be addressed.

Recent developments in the industry show, however, that inadequately planned market design experiments can result in the continuation, or even the expansion, of these problems. This is an industry that provides a necessary service to businesses and consumers across the country. Should SMD leave states open to future shortages, sustained high prices, and market manipulation, as experienced in California, the effects, both economic and personal, could be devastating. There is a need to remedy problems in this industry, whether or not they are related to undue discrimination. As the economy faces financial problems, however, there is a greater need for this industry, so vital to the economy, to have a consistent and stable economic and financial environment that will encourage competition where appropriate and investment as needed. The TRA opines that tighter regulation to prevent future adverse consequences in the industry, rather than the implementation of a new, broad, far-reaching, and untested standard market design, would be the better approach to create that stable environment.

Wherefore, given all the concerns raised by this *NOPR*, the Tennessee Regulatory Authority urges the Federal Energy Regulatory Commission to:

- Provide concrete evidence of continued instances of "*undue discrimination*" before any reforms are implemented;
- Provide a detailed cost-benefit analysis of the proposed SMD rule showing that the benefits of implementing SMD overweight the costs of inaction;
- Consider alternative regulatory approaches to the SMD that could solve most of the problems presented, as well as enhance economic efficiency;

- Prove that once SMD is implemented, the resulting rates will likely be just and reasonable, or that economic efficiency will most likely be enhanced relative to the risks created.

The Tennessee Regulatory Authority recommends that any action by the Commission to reform electricity markets should:

- Preserve state jurisdiction over bundled retail transmission service;
- Guarantee the ability of utilities to use their own facilities to serve their own customers, and fulfill their own service obligations on a cost-of-service basis under state and local laws and regulation;
- Consider that different regions of the country have different needs and circumstances, and that different regional market designs may be more appropriate than the one-size-fits-all approach proposed by the Commission.
- Include details of participant funding implementation and exclude limitations to its application;
- Include directives on how market power is to be measured and identified;
- Consider whether a Joint Board rather than an RSAC with adequate state representation, is the best approach to ensure that regional differences are incorporated in the SMD.

Respectfully Submitted

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